

ANNOUNCEMENTS

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PREFACE

All licensed hospitals in the State of Washington submit summary financial and utilization data to the Department of Health following each calendar quarter. Reported data are edited, summarized, and analyzed by Hospital and Patient Data Systems staff. Specific data elements are defined in the Department's *Accounting and Reporting Manual for Hospitals*. Utilizing these data, various financial and utilization rates and ratios are calculated to enhance the description of the financial condition of hospitals in the state. The purpose of this series of reports is to provide information describing emerging hospital utilization and financial trends to all concerned parties.

Rather than focusing on individual calendar quarters, the data in this report are aggregated into twelve month periods consisting of four calendar quarters each. This aggregation reduces the impact of seasonal fluctuations, which could distort actual trends occurring within the hospital industry.

The period covered by this report includes the last calendar quarter of 2003 and the first three calendar quarters of 2004. It provides a preview of where 2004 calendar year results are headed. However, this preview is subject to change. The

quarterly reports submitted by hospitals contain interim data which have not yet been subjected to audit review. Future adjustments and/or revisions as a result of both the hospital's internal accounting system review and the formal procedures of outside auditors may result in changes to previously submitted data. These future revisions will be reflected in the hospital's year-end reports. The year-end reports not only reflect audit adjustments but also provide substantially greater detail, which allows analysis of the information provided in greater depth.

SUMMARY

The annual growth rates of 12.9% for total patient service revenue, 16.2% for contractual adjustments, and 8.3% for net patient services revenue were the lowest recorded since the twelve month periods ended March 31, 1999, March 31, 1997, and March 31, 2001, respectively.

The four quarter period ended September 30, 2004 saw jumps of 53.4% in bad debt and 81.5% in charity care, resulting in an overall growth rate of 65.1% for uncompensated care. Uncompensated care accounted for 4.4% of total billed charges, which is a new high.

The increase of 8.3% in total operating expenses per adjusted discharge is considerably higher than both the 2.5% advance in the overall consumer price index and the 5.2% jump in the hospital services component of the index.

Statewide net operating income totaled \$329 million for the four quarter period ended September 30, 2004. This resulted in an operating margin of 3.37%. Gains of \$405 million in 63 hospitals were offset by losses of \$76 million in 32 hospitals.

Accounts receivable declined to 65.9 days of revenue for the four quarter period ended September 30, 2004. Although days in accounts receivable were up by 1.4 days for Medicare, they were down by 8.3 days for Medicaid and by 0.7 days for other payers.

The deductible proportion exceeded 50% for the first time ever in the twelve month period ended

September 30, 2004. This means that hospitals now realize less than half of total billed charges.

FINANCIAL INDICATORS

Total Patient Service Revenue

Total billed charges for patient services, which is identified as total patient service revenue, advanced by \$2.1 billion from \$16.3 billion to \$18.4 billion. The annual increase rate of 12.9% was less than any recorded since the four quarter period ended March 31, 1999. For the third consecutive quarter inpatient revenue grew more rapidly than outpatient revenue. The increase of 11.0% for other payer revenue was the smallest recorded since the twelve month period ended March 31, 1997.

Total Deductions from Revenue

For the twelve months ended September 30, 2004 total deductions from revenue reached \$9.3 billion. This was an increase of \$1.4 billion, or 17.9%. This is the first time since hospital financial records have been maintained by the Department of Health or the Washington State Hospital Commission that total deductions from revenue have been more than 50% of total patient service revenue.

Contractual Adjustments

For the four quarter period ended September 30, 2004 contractual adjustments reached \$8.9 billion. The annual increase rate of 16.2% was less than any recorded since the four quarter period ended March 31, 1997. By payer group contractual adjustments were up by 23.4% for Medicare, 13.6% for Medicaid, and 10.7% for other payers. The growth rate for Medicaid was the lowest realized since the four quarter period ended June 30, 1999. Contractual adjustments for Medicare and Medicaid reflect the difference between billed charges and the amounts that are actually paid. The difference between billed charges and the payment rates negotiated with major health insurers, managed care plans, HMO's, and other contractual payers is included in contractual adjustments for other payers.

Uncompensated Care

Uncompensated care is composed of charity care and bad debt expense. While charity care is part of the deductions from revenue category and bad debt is part of the operating expense category,

they are very similar. Each represents billed charges for hospital services that are not paid. Charity care represents charges that are not paid by patients who are **unable** to pay, while bad debt expense arises from charges that are not paid by patients who are **unwilling** to pay. While charity care is only 4.0% of deductions from revenue and bad debt expense is only 5.0% of operating expense, they have been growing very rapidly during the past year. Charity care has grown by 81.5% and bad debt has grown by 53.4%, for a total jump in uncompensated care of 65.1%. Over the past three years, charity care has leapt 197% and bad debts have expanded by 91% for a total increase in uncompensated care of 128%.

Net Patient Services Revenue

During the twelve month period ended September 30, 2004 net patient service revenue grew by 8.3%, or \$702 million, from \$8.4 billion to \$9.1 billion. This was the smallest annual percentage increase in net patient service revenue since the twelve month period ended March 31, 2001. Net patient service revenue is defined as the amount of revenue actually realized by hospitals. When deductions from revenue grow more rapidly than total patient service revenue, the growth rate of net patient service revenue is less than the rate of increase for total patient service revenue. This condition has existed in every four quarter period since the period ended March 31, 1996.

Operating Expenses

Growing by 8.3%, or \$673 million, operating expenses reached \$8.8 billion in the twelve month period ended September 30, 2004. Operating expenses are the costs of providing health care services to hospital patients. Since there was almost no change in aggregate volume during the period, operating expenses per adjusted discharge also increased by 8.3%. This increase substantially exceeded the 2.5% annual increase in the overall consumer price index and the 5.2% annual increase in the hospital services component of the index for the same time period. Although bad debt expense was only 5.0% of total operating expense, 23% of the total increase in operating expense was accounted for by bad debt expense. Without bad debt expense the increase in total operating expense would have been 6.6%.

Net Operating Income

During the four quarters ended September 30, 2004 net operating income advanced to \$329 million, which was 9.7% over the year ago level. Net operating income per adjusted discharge of \$353.12 was 9.7% over the year ago level. These were the smallest annual gains recorded since the twelve month period ended March 31, 2001. The rapid gain in uncompensated care is a major factor in holding back growth in net operating income. If uncompensated care had remained at the year ago level of 3.03%, net operating income could have grown to \$586 million.

Net operating income is not distributed uniformly among the hospitals of Washington. A total of 32 hospitals experienced operating losses totaling \$75.6 million, while 63 hospitals realized operating gains of \$404.7 million. For individual hospitals operating results ranged from a loss of \$19.3 million to a gain of \$78.9 million. Four hospitals had gains exceeding \$20 million for a total of \$159 million.

There was a wide variation by geographic region of increases and decreases in net operating income. The Central Washington region recorded an increase of 67.5%, while the Eastern Washington region recorded a reduction of 92.9%.

Net operating income tended to increase with increased urbanization. The frontier rural and remote rural regions recorded net operating losses, while the less remote rural and urban regions recorded net operating gains.

As a group district hospitals experienced an operating loss. Trends for proprietary hospitals may be distorted, since there are only seven hospitals in this grouping and two of those hospitals recently switched from not-for-profit status.

<u>Net Operating Income</u>	<u>Twelve Months Ended</u>		Change	Percent Change
	Sep 30, 2003	Sep 30, 2004		
Statewide Total	300,072,447	329,177,439	29,104,992	9.7%
By Geographic Region				
King County	112,336,991	135,856,084	23,519,093	20.9%
Puget Sound	142,898,959	135,989,692	(6,909,267)	-4.8%
Southwest Washington	23,907,047	31,647,548	7,740,501	32.4%
Central Washington	15,089,301	25,269,171	10,179,870	67.5%
Eastern Washington	5,840,149	414,944	(5,425,205)	-92.9%
By Population Density				
Frontier Rural	(2,050,955)	(3,488,006)	(1,437,051)	-70.1% *
Remote Rural	(5,840,410)	(6,449,555)	(609,145)	-10.4% *
Less Remote Rural	22,605,982	35,472,476	12,866,494	56.9%
Urban	285,357,830	303,642,524	18,284,694	6.4%
By Type of Ownership				
District	3,037,961	(6,127,509)	(9,165,470)	-301.7%
Not-for-Profit	263,859,270	305,574,141	41,714,871	15.8%
Proprietary	7,062,498	15,729,131	8,666,633	122.7%

*Mathematically, this is a positive percentage change. However, since the change is downward, a negative percentage change is less misleading.

UTILIZATION INDICATORS

Discharges, Patient Days, and Length of Stay

Discharges and patient days are the primary indicators of inpatient activity. Discharges from Washington hospitals continued to grow, reaching a total of 525,944 discharges during the four quarters ended September 30, 2004. This was a gain of 7,948 discharges, or 1.5%, over the corresponding year ago period. During the same

period patient days advanced to 2,284,517 patient days. This was an increase of 29,102 patient days, or 1.3%, over the corresponding year ago period. Since the increase rate for discharges exceeded the increase rate for patient days, average length of stay slipped to 4.34 days. Average length of stay has remained in the range of 4.34 days to 4.36 days since calendar year 2001.

Adjusted Discharges

Adjusted discharges reached a total of 932,186 in the four quarter period ended September 30, 2004. This was a decrease of 81 adjusted discharges, or 0.01%, from the four quarter period ended September 30, 2003. However, adjusted discharges were up 2,103 adjusted discharges, or 0.23% from the twelve month period ended June 30, 2004. Adjusted discharges are utilized as an aggregate indicator of hospital activity. To calculate adjusted discharges, inpatient discharges are

multiplied by the ratio of total patient service revenue to inpatient revenue (excluding skilled nursing facility revenue). With this adjustment, total patient service revenue per adjusted discharge is equal to inpatient revenue (excluding skilled nursing facility revenue) per inpatient discharge. Adjusted discharges are necessary for computing average rates, since total patient service revenue is the only financial indicator that can be split into inpatient and outpatient components.

OPERATING INDICATORS

Rates per Adjusted Discharge

Rates per adjusted discharge relate hospital financial indicators to the “average” patient. Total patient service revenue per adjusted discharge is the total bill for the average patient stay. Deductions from revenue per adjusted discharge is the portion of this average bill that is not paid by Medicare, Medicaid, or health insurers, or is written off as charity care. Net patient service revenue per adjusted discharge is the amount of revenue the hospital actually receives from the average patient stay. Operating expense per adjusted discharge is the cost of providing services to the average patient. Net operating income per adjusted discharge is the amount of money the hospital is able to earn from the average patient stay. Rates per adjusted discharge for the twelve month periods ended September 30, 2003 and September 30, 2004, and the percentage changes were:

<u>Rates per Adjusted Discharge</u>	<u>FYE 9/30/03</u>	<u>FYE 9/30/04</u>	<u>% Change</u>
Total Patient Service Revenue per Adjusted Discharge	\$17,484.36	\$19,749.23	+13.0%
Deductions from Revenue per Adjusted Discharge	8,425.09	9,935.93	+17.9%
Net Patient Service Revenue per Adjusted Discharge	9,059.27	9,813.31	+8.3%
Total Operating Expense per Adjusted Discharge	8,737.40	9,460.18	+8.3%
Net Operating Income per Adjusted Discharge	321.87	353.12	+9.7%

FINANCIAL RATIOS

The relationships between financial indicators are reflected by financial ratios. The financial ratios selected for this report are not all encompassing, but represent financial indicators that can be readily calculated from the data available through the quarterly reporting process as currently designed without requesting supplemental data from the reporting hospitals.

Days in Accounts Receivable

Accounts receivable is the largest item in the current assets portion of the balance sheet for most hospitals. Days in accounts receivable is a

measure of how “current” this asset is. In this report days in accounts receivable is calculated on an annual gross basis. On a statewide basis accounts receivable averaged 65.9 days for the four quarter period ended September 30, 2004. This was a reduction of 1.3 days, or 2.0%, from the corresponding year earlier period. Medicare accounts receivable increased by 1.4 days, or 2.9%, to 51.4 days. Accounts receivable for Medicaid dropped by 8.3 days, or 11.3%, to 65.2 days. A reduction of 0.7 days, or 0.9%, to an average of 76.1 days was also noted for other payer groups.

Operating Margin

During the twelve month period ended September 30, 2004 operating margin reached 3.37%, which was 0.5% above the year earlier level. If uncompensated care had remained at the year ago level of 3.03%, operating margin could have reached 6.00%.

In the Puget Sound region operating margin has held steady in the range of 5.5% to 6.5% over the past three years and is well above the other regions at 5.57% in the current reporting period. The Eastern Washington region recorded the smallest operating margin at 0.04%. Other regions were close to an operating margin level of 3.0%. Over the past three years frontier rural and remote rural areas have experienced

negative operating margins, while the less remote rural and urban regions have experienced positive operating margins. District hospitals have not recorded a positive operating margin since the four quarter period ended September 30, 2003. Trends for proprietary hospitals may be distorted, since there are only seven hospitals in this grouping and two of those hospitals recently switched from not-for-profit status.

<u>Operating Margin</u>	<u>Twelve Months Ended</u>		Change	Percent Change
	Sep 30, 2003	Sep 30, 2004		
Statewide Total	3.35%	3.37%	0.02%	0.5%
By Geographic Region				
King County	2.83%	3.15%	0.32%	11.3%
Puget Sound	6.44%	5.57%	-0.87%	-13.5%
Southwest Washington	2.56%	3.03%	0.46%	18.1%
Central Washington	1.83%	2.86%	1.03%	56.6%
Eastern Washington	0.59%	0.04%	-0.55%	-93.4%
By Population Density				
Frontier Rural	-3.15%	-4.54%	-1.39%	-44.1% *
Remote Rural	-2.21%	-2.17%	0.05%	2.1% **
Less Remote Rural	2.50%	3.55%	1.05%	42.0%
Urban	3.70%	3.62%	-0.08%	-2.2%
By Type of Ownership				
District	0.23%	-0.42%	-0.65%	-285.1%
Not-for-Profit	4.18%	4.44%	0.27%	6.3%
Proprietary	2.31%	5.01%	2.70%	117.1%

*Mathematically, this is a positive percentage change. However, since the change is downward, a negative percentage change is less misleading.

**Mathematically, this is a negative percentage change. However, since the change is upward, a positive percentage change is less misleading.

Deductible Proportion

The deductible proportion compares total deductions from revenue to total patient services revenue. For the twelve month period ended September 30, 2004 the deductible proportion reached 50.31%, which was 4.4% more than the year earlier level. The deductible proportion has grown every quarter since the four quarter period ended March 31, 1996. This is the first time that the deductible proportion has ever exceeded 50%. At the current level a hospital must bill \$2.01 to realize \$1.00 in net revenue. In the four quarter period ended March 31, 1996 the deductible proportion was 27.84% and a hospital needed to bill \$1.39 to realize \$1.00 in net revenue.

Contractual Proportion

The contractual proportion compares total contractual adjustments with total patient service revenue. Correspondingly, the Medicare contractual, Medicaid contractual, and other contractual proportions compare each payer group's contractual adjustments to the

corresponding total patient service revenue for the same payer group. The total contractual proportion reached 48.3%, which was an increase of 2.9% and another new high during the four quarter period ended September 30, 2004. This proportion has grown continuously since calendar year 1995. The Medicare contractual proportion of 58.0% and the Medicaid contractual proportion of 51.8% are well above the contractual proportion for other payers of 40.4%. This is a direct result of Medicare and Medicaid contractual adjustments growing faster than contractual adjustments for other payers every quarterly period since calendar year 2000.

Uncompensated Care Proportion

The bad debt proportion, charity proportion, and total uncompensated care proportion, compare bad debt expense, charity care, and total uncompensated care to total patient service revenue. In the four quarter period ended September 30, 2004, the bad debt proportion reached 2.40%, which was an increase of 35.8% over the previous year and was the highest noted

since the twelve month period ended September 30, 1990. The charity care proportion reached 2.03%, which was an increase of 60.7% over the previous year and was the highest noted since the twelve month period ended September 30, 1993. The total uncompensated care proportion reached 4.43%, which was an increase of 46.2% over the previous year, and was the highest noted since hospital financial records have been maintained by the Department of Health or the Washington State Hospital Commission. Total uncompensated care was 8.85% of patient service revenue for the other payer category. When combined with the contractual proportion for this group of payers, the total unrealized revenue totals 49.3%. However, this is well below the contractual proportion of 58.0% for Medicare somewhat below the contractual proportion of 51.8% for Medicaid.

Inpatient and Outpatient Revenue

The proportion of total revenue to inpatient revenue and the outpatient revenue percentage are alternate ways of looking at the relationship between inpatient and outpatient revenue. Between

the annual periods ended September 30, 2003 and September 30, 2004 the outpatient revenue percentage declined from 44.0% to 43.2%, while the ratio of total revenue to inpatient revenue slipped from 1.79 to 1.76. After peaking in the four quarter period ended June 30, 2003, these ratios have been slowly dropping.

Medicare and Medicaid Revenue

The Medicare revenue percentage and the Medicaid revenue percentage indicate the proportion of total hospital business that these programs represent. In the four quarter period ended September 30, 2004 the Medicare percentage was 34.9%, which was the highest recorded since the twelve month period ended June 30, 1996, while the Medicaid percentage was 15.1%. With 49.99% of total patient service revenue, which is the highest since the four quarter period ended March 31, 1996, the Medicare and Medicaid programs have a major influence on the financial health of hospitals.

hospTRENDS

Washington State

Hospital Financial and Utilization Trend Update Quarter Ended September 30, 2004

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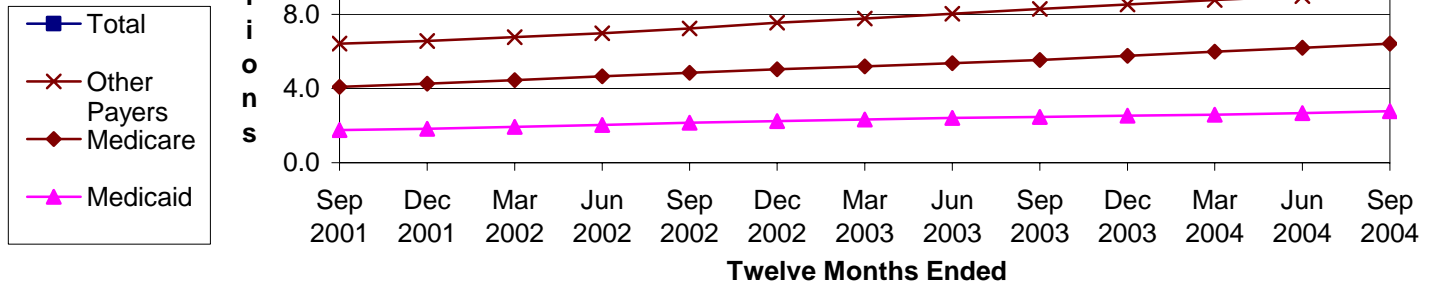
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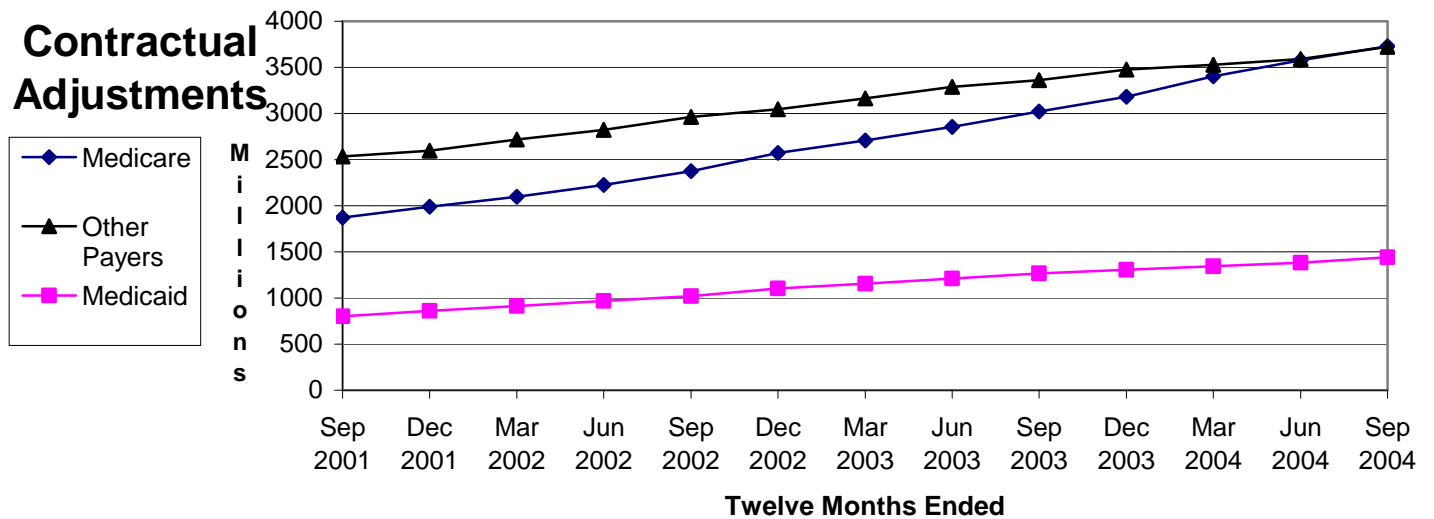
Teresa Jennings, State Registrar and Director
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Authors: Thomas Muller and Richard Ordos

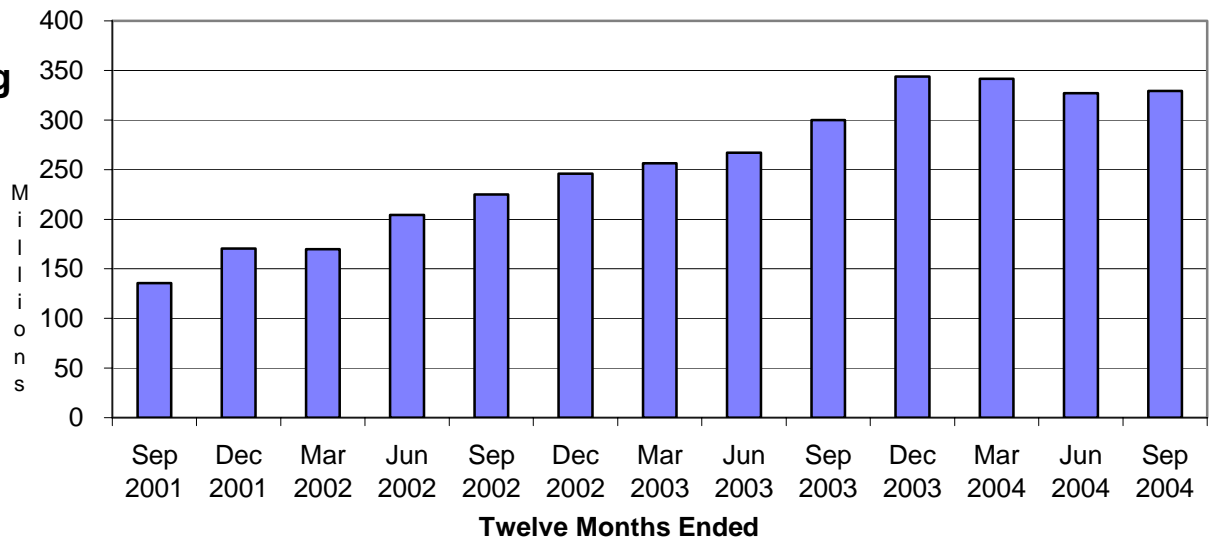
Total Patient Service Revenue



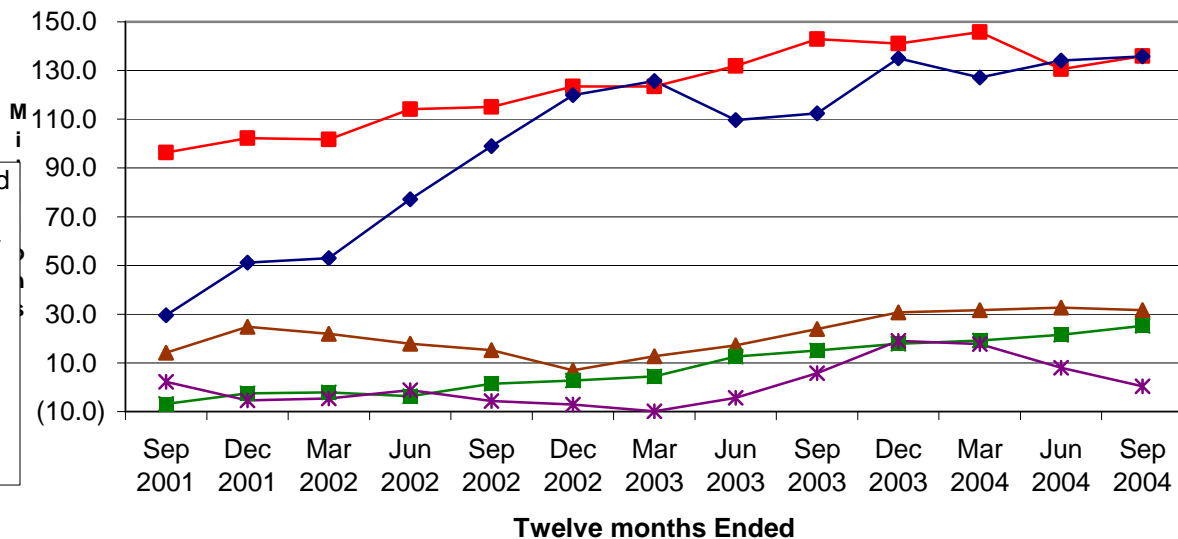
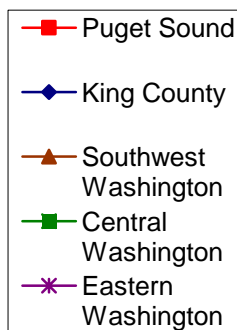
Contractual Adjustments



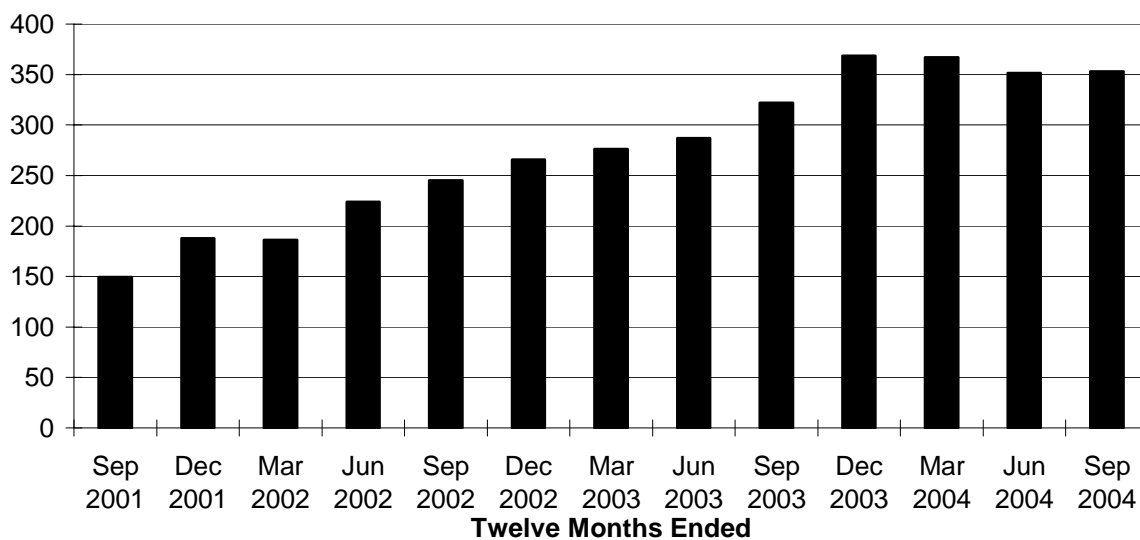
Net Operating Income



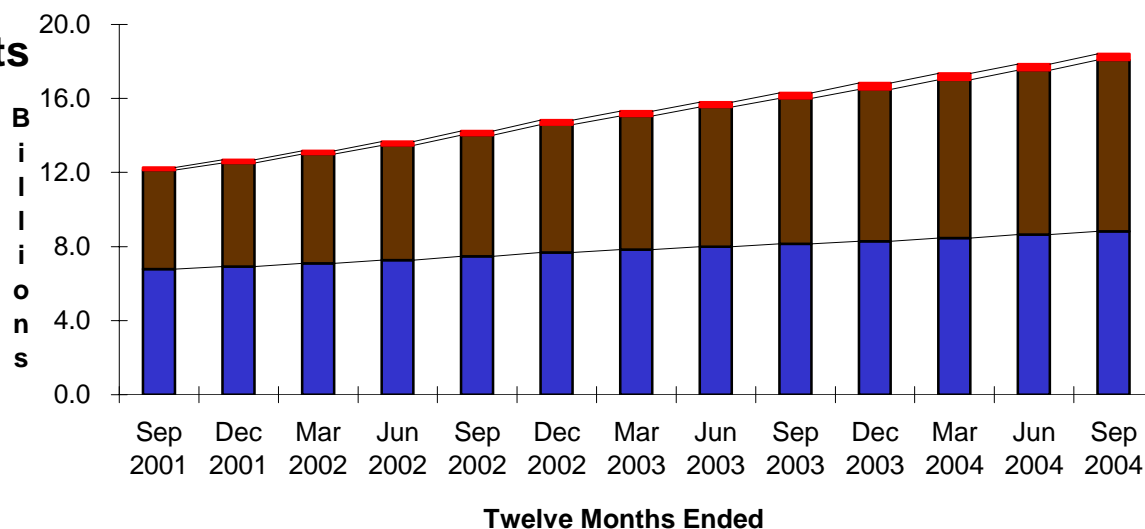
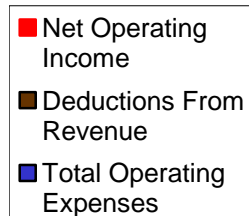
Net Operating Income

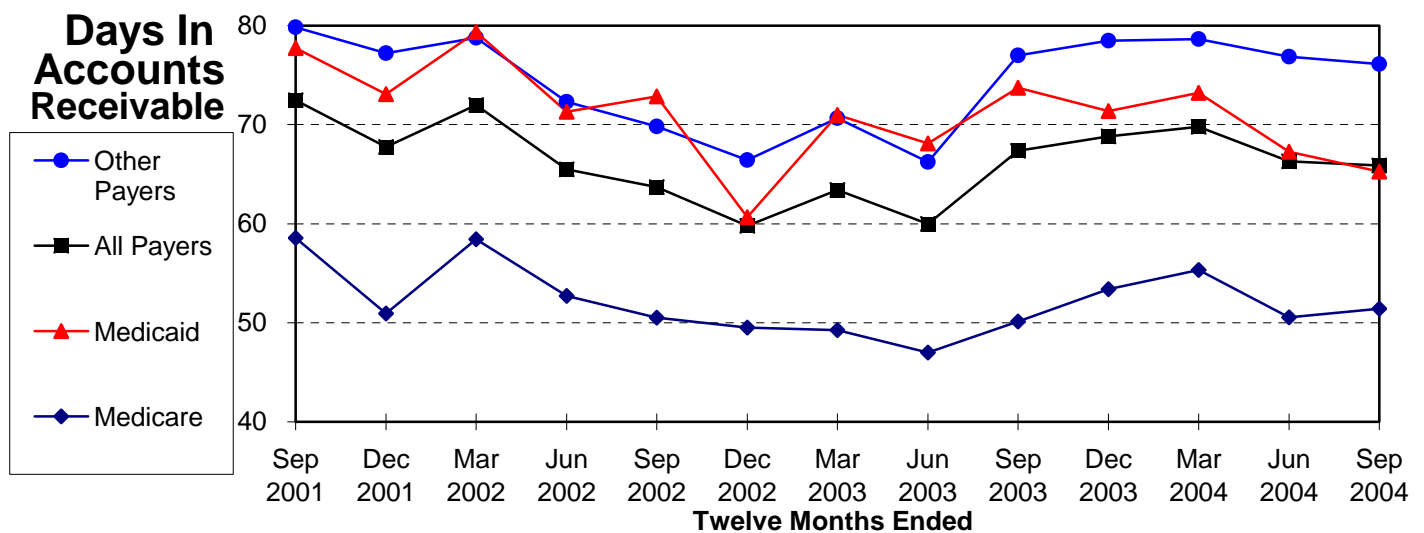
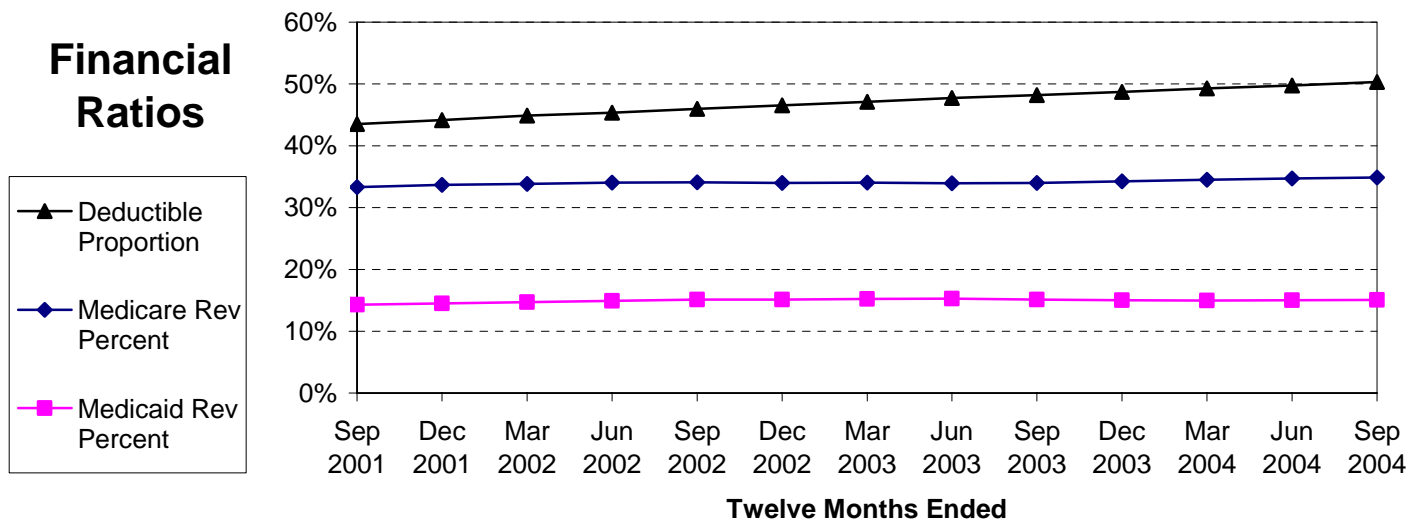
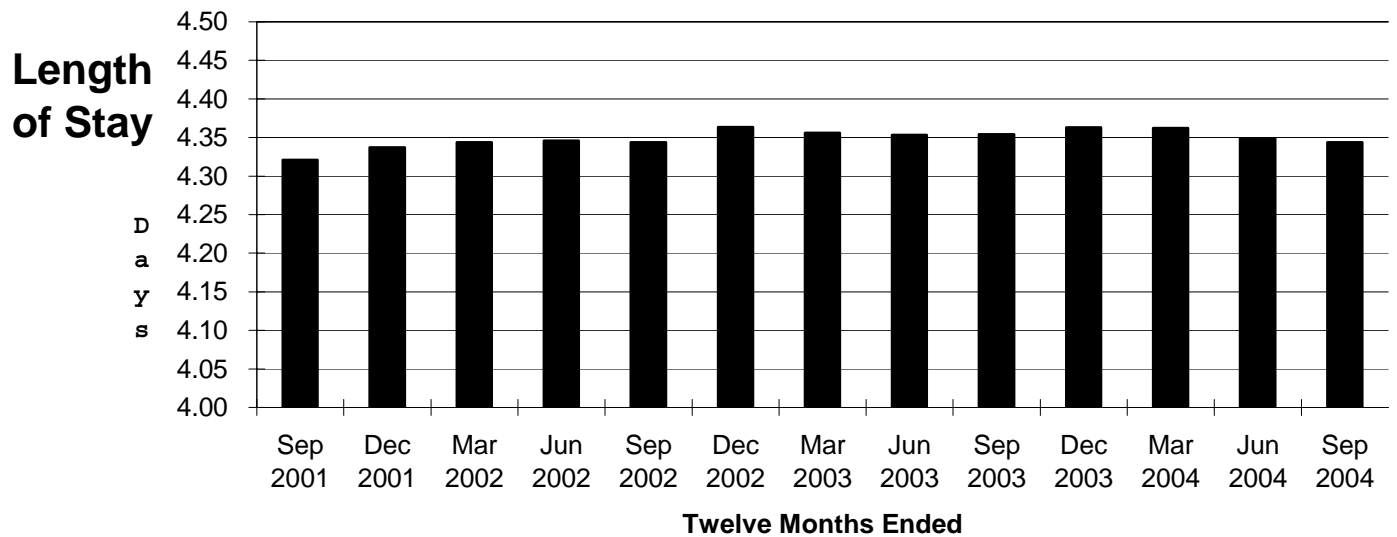


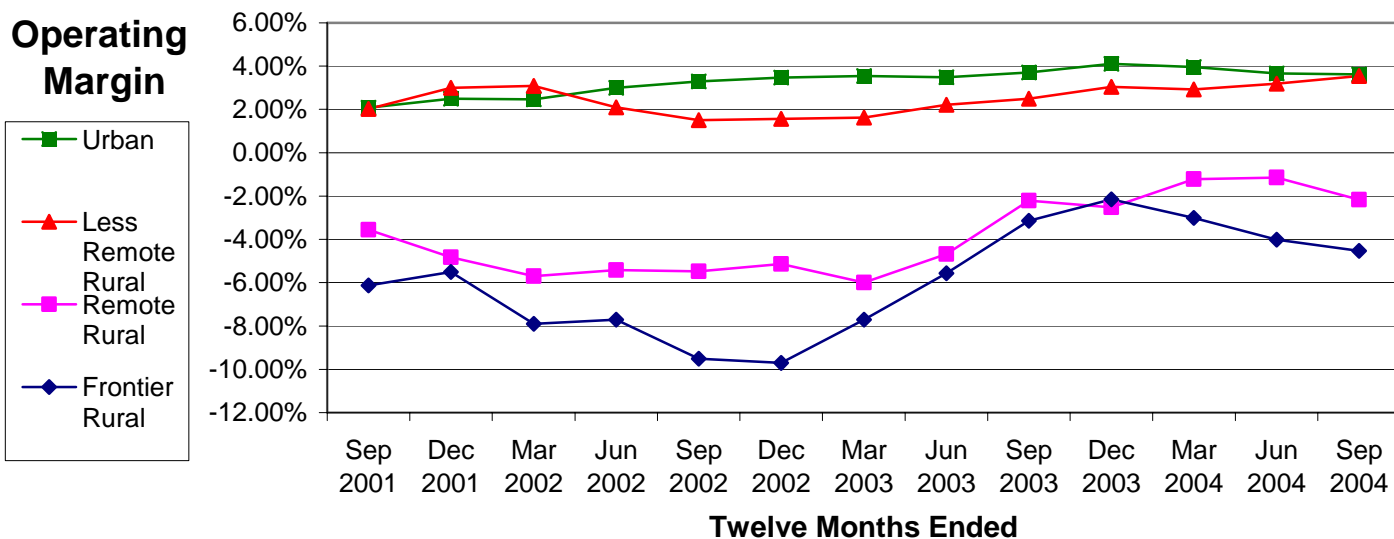
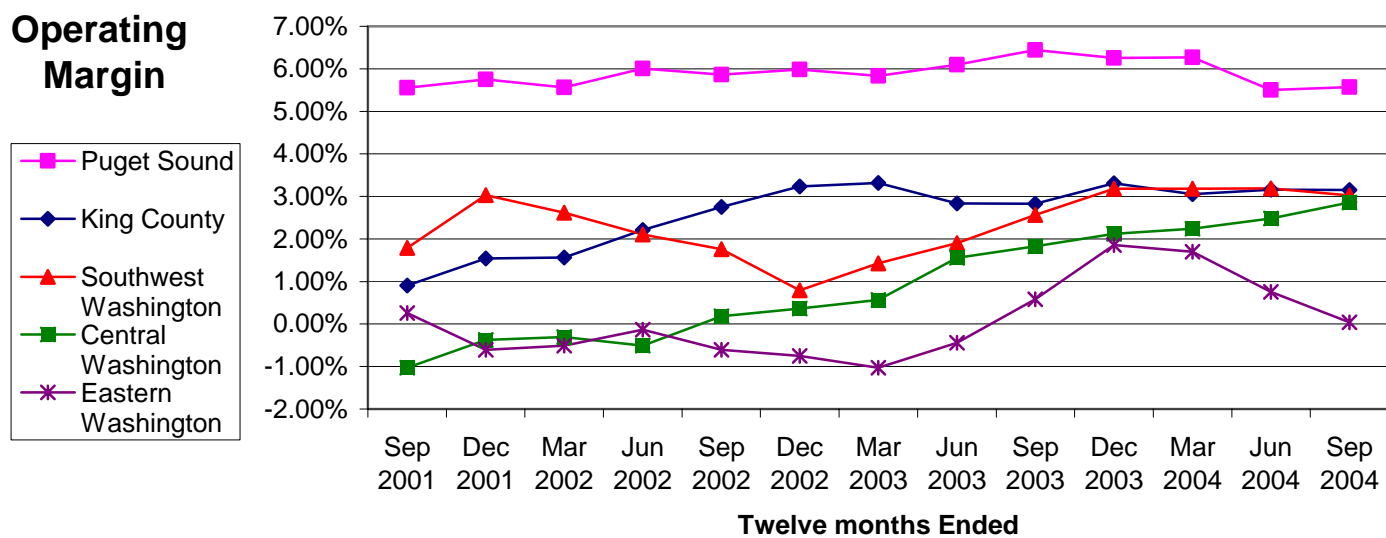
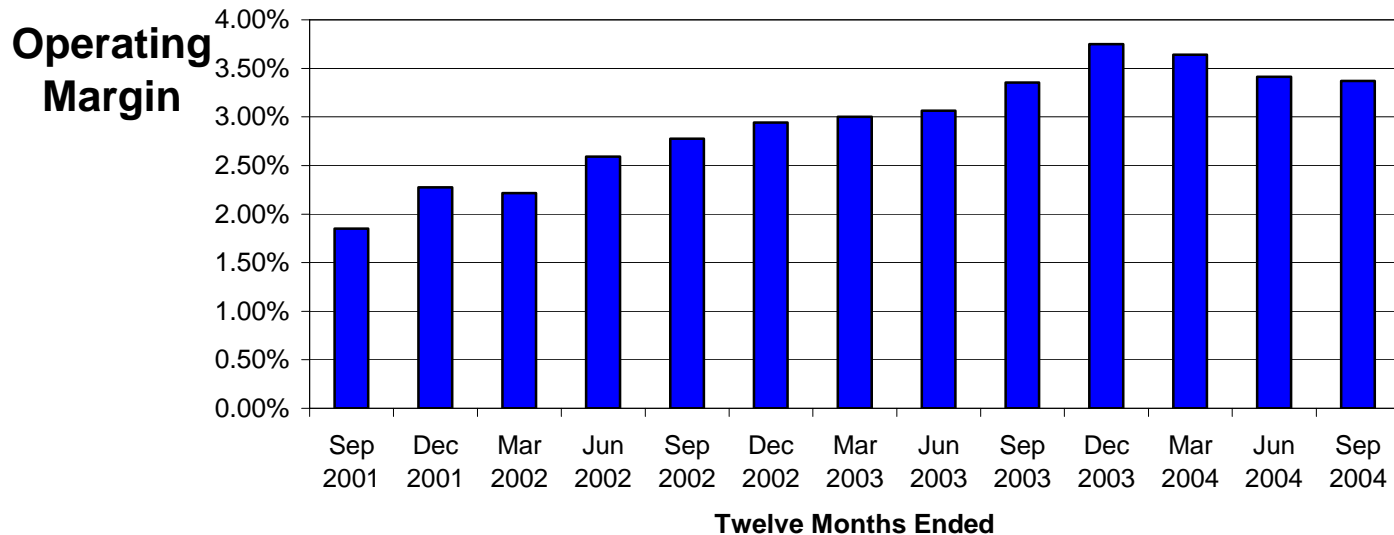
Net Income Per Adjusted Discharge



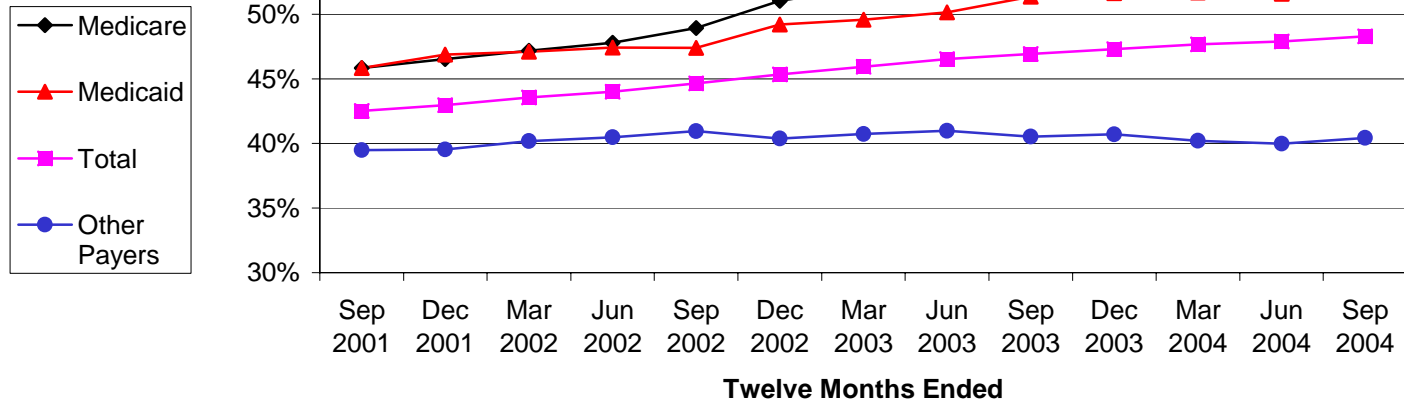
Components of Total Patient Revenue



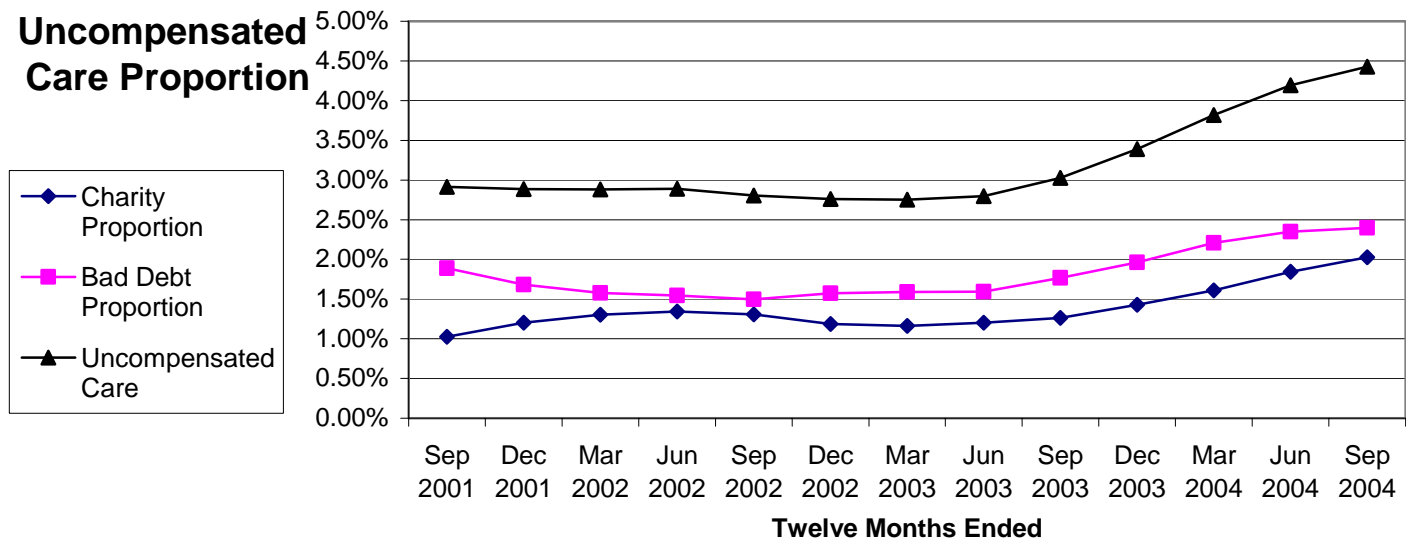




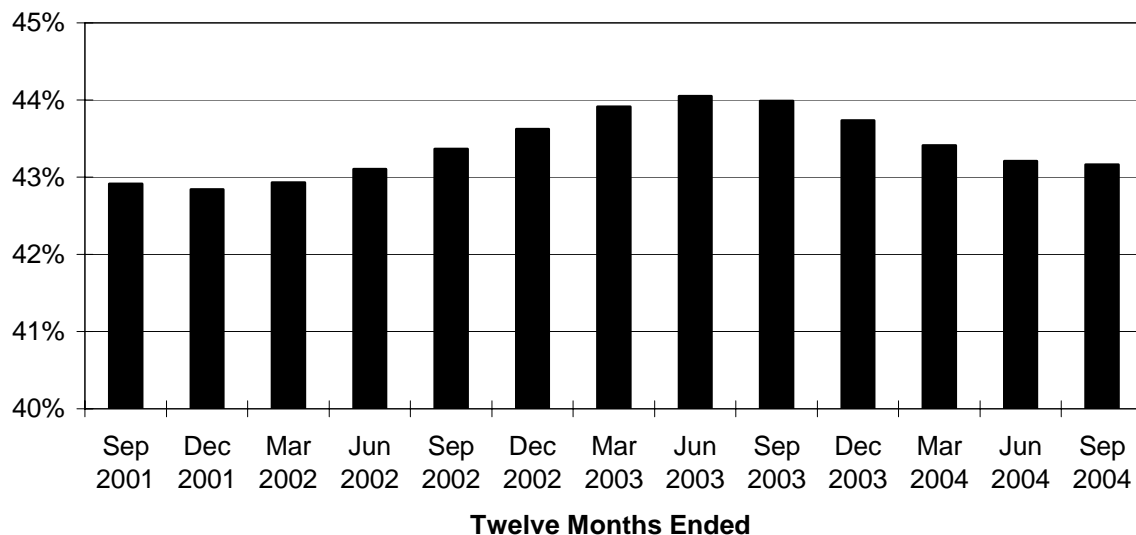
Contractual Proportion



Uncompensated Care Proportion



Percent Outpatient Revenue



HOSPITAL PERFORMANCE STATEWIDE	Twelve Months Ended Sep 30 2003	Twelve Months Ended Sep 30 2004	Total Change	Percent Change
Total Patient Revenue				
Inpatient	9,130,230,028	10,463,633,441	1,333,403,413	14.60%
Outpatient	7,169,861,632	7,946,326,449	776,464,817	10.83%
Total	16,300,091,660	18,409,959,890	2,109,868,230	12.94%
Medicare	5,538,917,610	6,424,132,944	885,215,334	15.98%
Medicaid	2,467,762,888	2,780,014,878	312,251,990	12.65%
Other	8,293,411,162	9,205,812,068	912,400,906	11.00%
Contractual Adjustments				
Medicare	3,019,737,151	3,727,710,068	707,972,917	23.44%
Medicaid	1,267,365,572	1,439,773,722	172,408,150	13.60%
Other	3,361,751,842	3,721,618,185	359,866,343	10.70%
Total	7,648,854,565	8,889,101,975	1,240,247,410	16.21%
Uncompensated Care				
Bad Debt	287,954,295	441,640,987	153,686,692	53.37%
Charity	205,575,387	373,030,439	167,455,052	81.46%
Total	493,529,682	814,671,426	321,141,744	65.07%
Net Patient Revenue				
Medicare	2,519,180,459	2,696,422,876	177,242,417	7.04%
Medicaid	1,200,397,316	1,340,241,156	139,843,840	11.65%
Other	4,726,083,933	5,111,163,444	385,079,511	8.15%
Total	8,445,661,708	9,147,827,476	702,165,768	8.31%
Total Operating Expenses	8,145,589,261	8,818,650,037	673,060,776	8.26%
Net Operating Income	300,072,447	329,177,439	29,104,992	9.70%
Days in Accounts Receivable				
Medicare	50.0	51.4	1.4	2.86%
Medicaid	73.5	65.2	(8.3)	-11.26%
Other Payers	76.8	76.1	(0.7)	-0.87%
Statewide Total	67.2	65.9	(1.3)	-1.98%
Utilization				
Discharges	517,996	525,944	7,948	1.53%
Patient Days	2,255,415	2,284,517	29,102	1.29%
Length of Stay	4.35	4.34	(0.01)	-0.24%
Adjusted Discharges	932,267	932,186	(81)	-0.01%
Rates per Adjusted Discharge				
Tot Revenue Per Adjusted Discharge	17,484.36	19,749.23	2,264.87	12.95%
Deductions Per Adjusted Discharge	8,425.09	9,935.93	1,510.84	17.93%
Net Revenue Per Adjusted Discharge	9,059.27	9,813.31	754.03	8.32%
Oper Expense Per Adjusted Discharge	8,737.40	9,460.18	722.78	8.27%
Net Income Per Adjusted Discharge	321.87	353.12	31.25	9.71%
Financial Ratios				
Operating Margin	3.35%	3.37%	0.02%	0.50%
Deductible Proportion	48.19%	50.31%	2.12%	4.41%
Contractual Proportion - Total	46.93%	48.28%	1.36%	2.90%
Contractual Proportion - Medicare	54.52%	58.03%	3.51%	6.43%
Contractual Proportion - Medicaid	51.36%	51.79%	0.43%	0.84%
Contractual Proportion - Other	40.54%	40.43%	-0.11%	-0.27%
Bad Debt Proportion	1.77%	2.40%	0.63%	35.79%
Charity Proportion	1.26%	2.03%	0.77%	60.66%
Uncompensated Care Proportion	3.03%	4.43%	1.40%	46.15%
Total Revenue/Inpatient Revenue	1.79	1.76	-0.03	-1.45%
Outpatient Revenue Percent	43.99%	43.16%	-0.82%	-1.87%
Medicare Revenue Percent	33.98%	34.89%	0.91%	2.69%
Medicaid Revenue Percent	15.14%	15.10%	-0.04%	-0.26%